

VZCZCXYZ0001  
PP RUEHWEB

DE RUEHCV #1146/01 2281712  
ZNY CCCCC ZZH  
P 151712Z AUG 08  
FM AMEMBASSY CARACAS  
TO RUEHC/SECSTATE WASHDC PRIORITY 1636  
INFO RUEHBO/AMEMBASSY BOGOTA 7843  
RUEHLP/AMEMBASSY LA PAZ AUG LIMA 1076  
RUEHQT/AMEMBASSY QUITO 2890  
RHEHNSC/NSC WASHDC  
RUMIAAA/HQ USSOUTHCOM MIAMI FL  
RUCPDO/DEPT OF COMMERCE  
RUEATRS/DEPT OF TREASURY

C O N F I D E N T I A L CARACAS 001146

SIPDIS

HQ SOUTHCOM ALSO FOR POLAD  
TREASURY FOR MEWENS  
NSC FOR JSHRIER  
COMMERCE FOR 4431/MAC/WH/MCAMERON

E.O. 12958: DECL: 08/15/2018

TAGS: [ECON](#) [PGOV](#) [VE](#)

SUBJECT: VENEZUELAN ECONOMY FALTERING AS ELECTION SEASON  
APPROACHES

REF: A. CARACAS 769  
[1](#)B. CARACAS 313  
[1](#)C. CARACAS 609  
[1](#)D. CARACAS 86  
[1](#)E. CARACAS 647  
[1](#)F. CARACAS 1081  
[1](#)G. CARACAS 68  
[1](#)H. CARACAS 376  
[1](#)I. CARACAS 600  
[1](#)J. CARACAS 838  
[1](#)K. CARACAS 494  
[1](#)L. CARACAS 532  
[1](#)M. CARACAS 1061  
[1](#)N. CARACAS 559  
[1](#)O. CARACAS 1127

Classified By: Economic Counselor Darnall Steuart for reasons 1.4  
(b) and (d).

[1](#)1. (C) Summary: Venezuela's economy appears increasingly fragile as campaigning begins to heat up for regional elections in November. The feeling of boom times has worn off in the face of increasing inflation, slower growth, tighter credit, and slowing consumption. The BRV has focused economic policy on reducing food shortages, largely through massive imports, and combating inflation by more tightly managing liquidity growth. Results have been mixed: shortages are fewer, but annual inflation has risen and liquidity appears to be rising again. There are indications the BRV is increasing the pace of fiscal spending in advance of the November elections, though not at the same rate as in past years. From a medium-term perspective, BRV policy and actions thus far in 2008 have in many cases only exacerbated underlying economic problems, particularly the lack of private sector investment. End summary.

-----  
The Numbers Show a Faltering Economy  
-----

[1](#)2. (SBU) After four years of strong growth driven largely by private consumption driven in turn by huge increases in government spending, Venezuela's economy has slowed down in 2008 more than the BRV, and even some independent economists, predicted. According to the Central Bank (BCV), growth in the first quarter of 2008 was 4.8 percent, a marked decrease from the 8.8 percent growth registered in the first quarter of 2007 and below the BRV's target of 6 percent for 2008 (ref

A). At the same time, annual inflation in metropolitan Caracas has increased from 22.5 percent at the close of 2007 to 33.7 percent as of July 2008. After growing over 60 percent in both 2006 and 2007, bank credit has stagnated, with banks' overall credit portfolios increasing only 10 percent from January to June 2008. Private consumption is still driving the economy, but its growth slowed to 11 percent in the first quarter of 2008 (down from 16 and 18 percent in the first quarters of 2007 and 2006, respectively). Gross fixed capital formation actually fell 1.8 percent in the first quarter of 2008.

¶3. (SBU) The faltering economy is affecting Venezuelans. For the first time in four years, the real purchasing power of most Venezuelans, including many of the poor Venezuelans who form Chavez' political base, appears to be declining (ref B). (Note: President Chavez' May 1 decree of a 30 percent wage hike for minimum wage and public sector workers (ref C) may have temporarily reversed this trend for those workers. End note.) Everyone is concerned about inflation. Although impossible to quantify, there seems to be a feeling throughout the country that the boom times of 2004-2006 are ending if not yet over.

-----  
Shortages Down, Inflation Up, Distortions Continue  
-----

¶4. (SBU) Reducing food shortages and combating inflation have been the BRV's two key short-term economic policy goals thus far in 2008. President Chavez, acutely aware that

discontent generated by the shortages contributed to the December 2007 defeat of his proposed constitutional reforms, ordered PDVSA to create a food production and distribution subsidiary in January 2008 (ref D) and directed CADIVI, the BRV's foreign exchange control authority, to prioritize food imports (refs E and F). The BRV has also raised price ceilings for many controlled goods or lifted price controls entirely, most recently on August 12 (septel). These policies have achieved partial success: the BCV's "scarcity indicator" for Caracas showed a decline from 25 percent at the turn of the year to 12 percent in July 2008. (Note: The scarcity index measures the percentage of times a BCV researcher could not find a given item at a given store during the monthly inflation survey. Prior to August 7, the BCV had not published this indicator in at least one year. End note.)

¶5. (SBU) The BRV has not succeeded to date in reducing inflation. As expected (ref G), the government appears to have prioritized addressing the shortages over addressing inflation, as the relaxing or lifting of price controls is inherently inflationary. The BRV's strategy of progressively tightening monetary policy and soaking up excess liquidity by selling dollar-denominated assets for bolivars (refs B and H) has reduced liquidity growth. M2, a measure of liquidity, grew 69 and 28 percent in 2006 and 2007 respectively, but it remained mostly stable for the first five months of 2008. Stable liquidity has not translated into reduced inflation, however, for reasons including inflationary expectations; stagnant domestic production; and the expression of repressed inflation (e.g., lifting or relaxing of price controls). Distortions due to BRV controls continue - automobile manufacturers are one sector particularly affected, thanks in part to their difficulty in getting dollars from CADIVI to import components (ref I).

-----  
Private Sector Not Welcome  
-----

¶6. (C) With much fanfare, Chavez announced on June 11 a series of measures to stimulate domestic production (ref J). Many of these measures were vague or of limited scope, however. Far more significant in terms of impact on the private sector were Chavez' announcements of his intent to nationalize major ceent companies (April 3; ref K), steel

producer Sidor (April 9; ref L), and Banco de Venezuela (July 31; ref M); the imposition of a windfall profits tax on oil producers (April 15; ref N); and the lws decreed by Chavez as the enabling law expired (August 1; ref O). These actions send a clear message that space for the private sector will continue to diminish, with the ancillary message being the best way to make money in the private sector is not to add value but to develop the right friends in the government. The Sidor nationalization in particular was framed in a way to invite further labor unrest: Chavez defended it as a measure to help Sidor's workers who, he claimed, were being exploited by the company's foreign owners. Understandably, very few private sector companies are making significant medium or long-term investments, and Venezuela's productive capacity is suffering accordingly.

-----  
Looking Ahead Through November  
-----

¶17. (C) Most local analysts expect government spending to pick up in advance of the November regional elections. There are signs it is: preliminary spending indicators are up and liquidity has increased 7 percent since mid-June. Spending is not expected to grow at past rates, however, as analysts note the BRV must balance its inflationary impact with its political benefits. (Note: In 2005 and 2006, primary central government spending grew at an astounding 43 and 48 percent, respectively; in 2007, it slowed to 11 percent. These figures do not account for increasing off-budget expenditures or "social spending" by PDVSA. End note.) Most analysts do not discount the possibility of another minimum wage increase before the elections or further

nationalizations, especially in the food sector. Inflation is expected to moderate slightly and end the year at around 30 percent. Despite the ever-increasing overvaluation of the bolivar with respect to the dollar (as the official exchange rate has been fixed at 2.15 bolivars/USD since March 2005), no one expects a devaluation before the elections for political reasons. Most analysts do expect some form of devaluation in 2009 to relieve the distortions associated with overvaluation.

-----  
Comment  
-----

¶18. (C) Venezuela's economy is faltering, and its underlying economic model, reinforced by BRV actions to date in 2008, is destined for failure. Economic problems such as inflation and declining purchasing power are politically damaging for Chavez and will be a factor in the November 2008 elections. Yet hardly anyone expects a purely economic crisis until at least 2010 for one simple reason: the price of oil. According to PDVSA, the average price of the Venezuelan basket per barrel has risen from USD 56 in 2006 to USD 65 in 2007 and USD 103 year-to-date in 2008. Even with oil production declining or stagnant, these dramatic price increases have given the BRV the resources necessary to ward off an economic crisis and postpone much-needed adjustments. End comment.  
DUDDY